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SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE
(EDRC) REVIEW OF UK ON FEBRUARY 24.

REF: (A) EDR(77)6; (B) LONDON 2885; (C) LONDON 20292;
(D) OECD PARIS 4809

1. SUMMARY: EMPHASIZING THAT THE ESSENTIAL ELEMENTS OF
RECOVERY WERE IN PLACE BY END OF 1976, UK DEL (LED BY
ISAAC, TREASURY) SAW FUNDAMENTAL TASK OF HMG AS INSURING
THAT DEMAND MANAGEMENT POLICY AND ITS TWIN SUPPORTING
PILLARS, INCOMES POLICY AND THE NEW INDUSTRIAL STRATEGY,
REMAINED FOCUSED ON ACHIEVEMENT OF SUSTAINABLE, EXPORT/
INVESTMENT LED GROWTH OVER THE MEDIUM TERM. EDRC CON-
SENSUS WAS THAT PRESENT POLICY STANCE AND RECENT DEVELOP-
MENTS APPEARED CONSISTENT WITH THIS OBJECTIVE, BUT THAT
MAJOR UNCERTAINTY WAS ATTACHED TO COURSE OF WAGES AND
PRICES FOLLOWING EXPIRATION OF PHASE II WAGE AGREEMENT.

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UK REFUSED TO BE DRAWN INTO DISCUSSION OF WHAT SPECIFIC
FORM A PHASE III WAGE AGREEMENT MIGHT TAKE OR OF POLICY
OPTIONS HMG WOULD CONSIDER SHOULD AGREEMENT PROVE
IMPOSSIBLE. UK INSISTED UPON IMPORTANCE OF SECURING
WAGE AGREEMENT, WHILE EDRC LEANED TOWARD VIEW THAT WAGE
RESTRAINT, RATHER THAN ACHIEVEMENT OF FORMAL WAGE AGREE-
MENT, SHOULD BE CENTRAL HMG OBJECTIVE.

2. UK EXPRESSED GENERAL AGREEMENT WITH THRUST OF SECRETARIAT'S ANALYSIS AND POLICY RECOMMENDATIONS, INCLUDING MEDIUM-TERM EMPHASIS ON INVESTMENT AND EXPORT-LED GROWTH. THEY INDICATED, HOWEVER, THAT SECRETARIAT HAD (A) MIS-INTERPRETED STANCE AND OBJECTIVES OF MONETARY POLICY IN 1976 AND EARLY 1977; (B) NOT FULLY APPRECIATED MAGNITUDE OF RESTRICTIVE POLICY SHIFT IN 1976 AND (C) TOOK OVERLY-SANGUINE VIEW OF EXTENT TO WHICH NORTH SEA OIL WOULD RELAX CURRENT ACCOUNT CONSTRAINT AND ALLOW MORE RAPID GROWTH OF CONSUMPTION OVER MEDIUM TERM. DURING DISCUSSION AT EDRC, SECRETARIAT AND UK REACHED MEETING OF MINDS ON THESE ISSUES (SEE PARAS 16, 15 AND 20 BELOW).

3. DISCUSSION OF PROSPECTS FOR 1977 WAS LARGELY IN QUALITATIVE TERMS WITH UK PROJECTING SOMEWHAT HIGHER GDP GROWTH AND LARGER CURRENT ACCOUNT DEFICIT THAN SECRETARIAT. NEVERTHELESS, SECRETARIAT AND UK AGREED THAT GDP GROWTH IN 1977 WOULD BE MODERATE, THAT CURRENT ACCOUNT WOULD IMPROVE SUBSTANTIALLY DURING THE YEAR AND THAT INFLATION RATE WOULD DECELERATE (ALTHOUGH, UNLIKE SECRETARIAT, UK NO LONGER SEES INFLATION RATE DROPPING INTO SINGLE DIGIT RANGE BY END OF YEAR). END SUMMARY

4. SHORT-TERM PROSPECTS: UK SET STAGE FOR DISCUSSION OF SHORT-TERM OUTLOOK AND POLICIES BY EMPHASIZING THAT THE FOLLOWING ELEMENTS ESSENTIAL TO RECOVERY HAD BEEN PUT INTO PLACE BY THE END OF 1976: (A) PAY POLICY SUCCESSFUL IN REDUCING DOMESTICALLY GENERATED INFLATION; LIMITED OFFICIAL USE

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(B) INDUSTRIAL STRATEGY PROGRESSING AND HAS PRODUCED SIGNIFICANT IMPROVEMENT IN INDUSTRIAL RELATIONS; (C) PUBLIC EXPENDITURE CUTS OUTLINED IN JANUARY WHITE PAPER WILL HOLD LEVEL OF REAL PUBLIC EXPENDITURE TWO YEARS HENCE BELOW LEVEL OF CURRENT FINANCIAL YEAR. IMPLEMENTATION OF "CASH LIMITS" ON SPENDING WILL HELP INSURE ATTAINMENT OF THIS OBJECTIVE; (C) EXPECTED REDUCTION IN PSBR WILL PERMIT DOMESTIC CREDIT TO EXPAND IN LINE WITH TARGETS (SET OUT IN LETTER OF INTENT TO IMF) WITHOUT EXCESSIVE LEVEL OF INTEREST RATES; (D) IMF STANDBY WILL PROVIDE MOST OF BRIDGING FINANCE NEEDED IN 1977, AND TOGETHER WITH BASLE AGREEMENT ON STERLING BALANCES, HAD ENHANCED CONFIDENCE AND CONTRIBUTED TO RESTORATION OF ORDERLY EXCHANGE MARKETS (UK NOTED, HOWEVER, THAT PRESENT EUPHORIA SURROUNDING STERLING WOULD PROBABLY NOT LAST) AND (E) EXTERNAL BALANCE SHEET HAS IMPROVED AND RESERVES POSITION IS STRONGER.

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5. DOMESTIC OUTLOOK: UK DEL NOTED THAT HMG HAD NOT COMPLETED FSMAL REVISION OF OFFICIAL FORECASTS MADE IN DECEMBER, 1976 (SEE REF C), BUT SAID THAT DATA OVER LAST TWO MONTHS INDICATED THAT GROWTH OF REAL GDP IN 1977 WOULD BE SOMEWHAT LESS THAN THE 2 PERCENT FORECAST IN DECEMBER. MAIN DIFFERENCE BETWEEN UK AND SECRETARIAT FORECASTS FOR 1977 GDP GROWTH CONCERNED TIME PROFILE OF PRIVATE CONSUMPTION SPENDING DURING YEAR. WHEREAS SECRETARIAT SEES SHARP FALL IN REAL DISPOSABLE INCOME LEADING TO 5 PERCENT (ANNUAL RATE) FALL OF PRIVATE CONSUMPTION IN FIRST HALF OF 1977 WITH PICKUP THEREAFTER, UK EXPECTS CHANGES IN SAVINGS RATE TO OFFSET MOVEMENTS IN DISPOSABLE INCOME PRODUCING SMOOTHER (ALBEIT DECLINING) PATH OF PRIVATE CONSUMPTION. UK ALSO FORESEES SOMEWHAT HIGHER MANUFACTURING INVESTMENT, BUT RELATIVELY LESS CONTRIBUTION TO GDP GROWTH FROM REAL FOREIGN BALANCE AND POSITIVE ASSIST TO GROWTH FROM INVENTORY ACCUMULATION. SECRETARIAT AND UK THUS AGREED THAT THERE WAS NO SIGNIFICANT DIFFERENCE BETWEEN THEIR REAL GDP FORECASTS FOR 1977. UK OBSERVED

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THAT PROBABLE SLOW GROWTH OF DEMAND RENDERED EMERGENCE OF SUPPLY CONSTRAINTS UNLIKELY. HOWEVER, THEY ADDED THAT WHILE LABOR WAS ABUNDANT, DEGREE OF UNDERUTILIZATION OF CAPITAL STOCK WAS LESS THAN WOULD BE INDICATED BY USUAL (E.G., WHARTON) MEASURES OF CAPACITY BECAUSE OF LOW INVESTMENT IN RECENT YEARS.

6. WAGES AND PRICES: UK NOTED THAT WAGE INCREASES IN 1976 HAD BEEN WITHIN GUIDELINES ESTABLISHED UNDER PHASE II AGREEMENT (AUGUST, 1976 - AUGUST, 1977) AND WAS THUS OPTIMISTIC THAT WAGE INCREASES WOULD BE RELATIVELY MODERATE IN FIRST HALF OF 1977. EDRC SHARED UK'S OPTIMISM IN THIS RESPECT (ALTHOUGH NOTING AVERAGE WAGE RATES IN THE PAST HAD INCREASED FASTER THAN WHAT MIGHT HAVE BEEN EXPECTED UNDER PAY POLICY NORMS), BUT FELT THAT MAJOR UNCERTAINTY LAY IN COURSE OF WAGES AND PRICES FOLLOWING EXPIRATION OF PHASE II WAGE AGREEMENT IN AUGUST, 1977. SOME EDRC DELS POINTED TO POSSIBLE DIFFICULTIES HMG MIGHT ENCOUNTER IN CONVINCING LABOR TO SIGN ON TO A PHASE III ACCORD. IN PARTICULAR, U.S. NOTED THAT RISE IN UNEMPLOYMENT COULD LEAD LABOR TO CONCLUDE THAT EXPECTED PAYOFF FOR WAGE RESTRAINT HAD NOT MATERIALIZED, AND ASKED WHETHER RECENT PRICE CONTROL PROPOSALS WERE INTENDED TO "SWEETEN POT" SOMEWHAT. UK RESPONDED THAT SUGGESTED CHANGES IN PRICE CONTROLS SHOULD NOT BE SEEN IN THIS LIGHT SINCE TUC (AND UNION MEMBERSHIP) AND HMG WERE IN SAME CAMP; LABOR RECOGNIZED THAT EXCESSIVE WAGE DEMANDS WOULD BRING MORE INFLATION AND HIGHER UNEMPLOYMENT AND WAS THUS CONVINCED THAT CONCLUSION OF A PHASE III ACCORD WOULD BE IN ITS OWN INTEREST. (THEY ALSO NOTED THAT PRICE CONTROLS WOULD BE AN ESSENTIAL PART OF ANY WAGE AGREEMENT, BUT DID NOT EXPLAIN POSSIBLE INCONSISTENCY OF THIS WITH OTHER STATEMENTS.)

7. OTHER DELS ASKED IF HMG HAD EXPLORED QUESTION OF WHAT POLICY OPTIONS WOULD BE AVAILABLE IN EVENT THAT NEW WAGE LIMITED OFFICIAL USE

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AGREEMENT COULD NOT BE HAMMERED OUT. UK STRESSED THAT IT WAS INCONCEIVABLE THAT A LABOR GOVERNMENT WOULD NOT BE ABLE TO REACH AGREEMENT WITH THE TRADE UNIONS. OBVIOUSLY, THEY SAID, IT WAS NECESSARY TO "THINK THE UNTHINKABLE," BUT IT DID NOT FOLLOW THAT THEY SHOULD "SPEAK THE UNSPEAKABLE" (I.E., IN THE EDRC). AUSTRALIAN DEL ACCEPTED UK VIEW THAT PHASE III WOULD BE POSSIBLE TO NEGOTIATE, BUT SUGGESTED THAT PRICE OF AGREEMENT COULD BE SO HIGH AS TO MAKE IT WORSE THAN HAVING NO PHASE III. HE CITED THIS POSSIBILITY AS MAIN DANGER IN MAKING NEGOTIATED AGREEMENT PER SE, RATHER THAN GENERALIZED OBJEC-

TIVE OF WAGE RESTRAINT, THE CENTERPIECE OF GOVERNMENT
POLICY. SOME OTHER DELS AND SECRETARIAT LEANED TOWARD
AUSTRALIAN VIEW, BUT UK DID NOT ADDRESS THIS ISSUE.

8. UK WAS ALSO RELUCTANT TO BE DRAWN INTO DISCUSSION OF
SHAPE OF POSSIBLE PHASE III ACCORD. ASKED WHETHER HMG
WOULD PROPOSE PERCENTAGE WAGE MEASURES TO HALT COMPRES-
SION OF WAGE DIFFERENTIALS, OR WHETHER TAX REDUCTIONS
MIGHT BE PART OF PACKAGE, UK ONLY NOTED THAT SEVERAL
OPTIONS WERE UNDER CONSIDERATION.

9. CONCERNING OTHER ELEMENTS IN TOTAL PRICE PICTURE, UK
STATED THAT LAGGED EFFECTS OF SHARP DEPRECIATION OF STER-
LING IN AUTUMN, 1976 WOULD LEAD TO ACCELERATION OF

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INFLATION IN EARLY 1977. THEY INDICATED THAT BECAUSE OF
STERLING DEPRECIATION, IT WAS NOT LIKELY THAT ANNUAL RATE
OF INFLATION WOULD FALL INTO SINGLE DIGIT RANGE BY END
OF 1977 AS FORECAST BY SECRETARIAT. FINALLY, UK STATED
THAT HMG REMAINED FIRMLY AGAINST DEVALUATION OF "GREEN
POUND" IN 1977 AND EXPLAINED THAT SUCH A DEVALUATION
WOULD SHATTER PROSPECTS FOR OBTAINING A NEW WAGE AGREE-
MENT. SECRETARIAT AND UK AGREED THAT INFLATION RATE
WOULD DECELERATE CONSIDERABLY DURING SECOND HALF OF 1977.

10. CURRENT ACCOUNT: UK INDICATED THAT DECEMBER FORECAST OF \$2 BILLION CURRENT ACCOUNT DEFICIT MIGHT BE ON HIGH SIDE, BUT THAT OUTLOOK WAS SUBJECT TO CONFLICTING INFLUENCES WHOSE NET EFFECT WAS UNCERTAIN. SPECIFICALLY, UK POINTED TO FOLLOWING FACTORS WHICH WOULD AFFECT EVOLUTION OF CURRENT ACCOUNT: (A) EXPECTED SLOWER GROWTH OF GDP WOULD HAVE DAMPENING EFFECT ON IMPORTS; (B) EXTENT TO WHICH SURGE IN IMPORTS IN 1976 DUE TO SPECIAL FACTORS WHICH WILL BE REVERSED IN 1977 OR DUE TO PERMANENT RISE IN IMPORT PROPENSITY IS NOT YET CLEAR; (C) DETERIORATION LIMITED OFFICIAL USE

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OF RELATIVE COST POSITION AND APPRECIATION OF STERLING IN LATE 1976 HAS ERODED UK COMPETITIVE EDGE; UK THUS LESS OPTIMISTIC CONCERNING MARKET SHARES IN 1977; (D) RELATIVE STABILITY OF COMMODITY PRICES AND RECENT APPRECIATION OF STERLING LEAD UK TO BE OPTIMISTIC (COMPARED WITH SECRETARIAT) RE EVOLUTION OF TERMS OF TRADE THIS YEAR; AND, (E) NORTH SEA OIL PRODUCTION NOT LIKELY TO HAVE MAJOR INFLUENCE IN CURRENT ACCOUNT IN 1977. SECRETARIAT ASSUMES OIL WOULD MOVE CURRENT ACCOUNT INTO SURPLUS IN SECOND HALF OF YEAR. WHILE LESS OPTIMISTIC THAN SECRETARIAT RE POSITIVE CONTRIBUTION OF OIL TO CURRENT ACCOUNT BALANCE IN 1977, HMG FORECASTS TREND TOWARD IMPROVEMENT IN CURRENT ACCOUNT DURING YEAR.

11. UK QUESTIONED SECRETARIAT PROPOSITION REFDOC THAT INCREASING TENDENCY OF UK EXPORTERS TO SET EXPORT PRICES IN FOREIGN CURRENCY HAD DILUTED EFFECT OF DEPRECIATION ON EXPORT VOLUMES. THEY FELT THAT RESULTING INCREASE IN PROFITABILITY IN EXPORT SECTOR WHICH THIS PRACTICE IMPLIED WOULD GENERATE RESOURCE SHIFT CONSISTENT WITH HMG'S MEDIUM-TERM OBJECTIVES. MOREOVER, THEY STRESSED IMPORTANCE OF NON-PRICE FACTORS (SALES EFFORT, PRODUCT QUALITY, DELIVERY TIMES, ETC.) IN EXPORT PERFORMANCE AND NOTED THAT HIGHER PROFITS WOULD BE CONDUCIVE TO INCREASED EFFORTS FOR IMPROVEMENT IN THESE AREAS. IN THIS CONNECTION, UK COMMENTED THAT DISCUSSIONS BETWEEN GOVERNMENT, BUSINESS AND LABOR IN FRAMEWORK OF NEW INDUSTRIAL STRATEGY DEALT TO IMPORTANT EXTENT WITH WAYS IN WHICH NON-PRICE COMPETITIVENESS COULD BE ENHANCED.

12. UK FELT THAT WHILE CURRENT EUPHORIA IN EXCHANGE MARKETS WOULD PROBABLY NOT LAST, IMPLEMENTATION OF RESTRICTIVE POLICIES, IMF STANDBY, BASLE AGREEMENT ON STERLING BALANCES AND NORTH SEA OIL WOULD CONTRIBUTE TO MAINTENANCE OF ORDERLY MARKET CONDITIONS DURING 1977. QUESTION WAS RAISED AS TO WHETHER RECENT HEAVY CAPITAL INFLOWS LIMITED OFFICIAL USE

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WOULD BE DESTABILIZING AND/OR INCONSISTENT WITH UK'S MEDIUM-TERM GOAL OF REDUCING STERLING BALANCES. UK INDICATED THAT INFLOWS WERE PARTLY ATTRIBUTABLE TO REVERSAL OF UNFAVORABLE MOVEMENTS OF "LEADS AND LAGS" LAST AUTUMN AND THUS SHOULD BE CONSIDERED AS RETURN TO NORMAL, NOT AS DESTABILIZING INFLUENCES. MOREOVER, THEY POINTED OUT THAT REGULATION PROHIBITING THIRD-COUNTRY TRANSACTION IN STERLING HAD LED TO "ONE-SHOT" CAPITAL INFLOW OF \$500 MILLION - \$1 BILLION DOLLARS (\$1 BILLION IS THE HIGHEST FIGURE UK HAS EVER CITED IN DISCUSSING EFFECTS OF THIS REGULATION). THEY CONSIDERED THESE DEVELOPMENTS TO BE ENTIRELY CONSISTENT WITH OBJECTIVE OF REDUCING STERLING BALANCES.

13. FISCAL AND MONETARY POLICIES; FISCAL POLICY: UK STATED THAT CUTS IN PUBLIC EXPENDITURES SINCE JULY WERE INTENDED TO REDUCE PSBR AND THEREBY FREE RESOURCES FOR EXPORTS AND INVESTMENT. MOREOVER, THEY NOTED THAT PREVIOUS PROJECTION OF PSBR IN FY-1976/77 (11.2 BILLION POUNDS) COULD WELL BE TOO HIGH. IF SO, THE ESTIMATED 8.7 MILLION POUNDS PSBR ENVISAGED FOR FY-1977/78 WOULD ALSO BE REDUCED BECAUSE (A) A LOWER PSBR IN FY-1976/77 WOULD REDUCE BOTH TOTAL DEBT AND LEVEL OF INTEREST RATES

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(GIVEN MONETARY TARGET) WITH RESULT THAT INTEREST CHARGES WOULD BE LESS IN 1977/78; (B) ALLOW LENGTHENING OF MATURITY STRUCTURE OF PUBLIC DEBT. HOWEVERHOWEVER, SINCE PAYMENTS ON LONG-TERM DEBT ARE MADE TWICE A YEAR (AS OPPOSED TO MONTHLY PAYMENTS ON SHORT-TERM DEBT), INCREASED SHARE OF PAYMENTS WOULD BE POSTPONED UNTIL FY-1978/79.

14. NOTING SECRETARIAT STATEMENT REFD0C THAT DECEMBER CUTS IN PUBLIC EXPENDITURE WERE NOT SUBSTANTIAL IN THEMSELVES, UK EXPRESSED VIEW THAT SECRETARIAT HAD FAILED TO GIVE FULL APPRECIATION OF MAGNITUDE OF CUTS. ACCORDING TO UK, ASSESSING IMPORTANCE OF CUTS IN TERMS OF PERCENTAGE OF GDP WAS INAPPROPRIATE; RELEVANT COMPARISON SHOULD BE MADE BY EXAMINING COUNTERFACTUAL CASE; I.E., WHAT WOULD HAVE HAPPENED IN ABSENCE OF CUTS. SECRETARIAT DID NOT REACT AT EDRC MEETING.

15. U.S. POINTED OUT THAT RECENT CUTS IN PUBLIC INVESTMENT APPEARED TO BE IN CONFLICT WITH SIMULTANEOUS ACHIEVEMENT OF MEDIUM GOALS OF INCREASING INVESTMENT AND REDUCING
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BOTH DIRECT TAXATION AND PSBR (I.E., PROPORTION OF PUBLIC SECTOR SHARE IN GNP). UK RESPONDED THAT AIM WAS TO INCREASE TOTAL INVESTMENT, BUT WITH SHIFT OF EMPHASIS FROM PUBLIC TO PRIVATE INVESTMENT, A SHIFT IN WHICH NEW INDUSTRIAL STRATEGY WOULD PLAY AN IMPORTANT ROLE. U.S. ALSO NOTED THAT IN CONCLUSIONS SECTION OF REFD0C, SECRETARIAT HAD OVERLOOKED IMPORTANCE OF PROFITS IN STIMULATING INVESTMENT OVER MEDIUM TERM. WHILE NOTING THAT SUCH A RECOMMENDATION COULD BE DAMAGING TO INCOMES POLICY (SINCE WITH SLOW GROWTH, PROFITS COULD ONLY INCREASE AT EXPENSE OF WAGES) IF PLACED IN SHORT-RUN CONTEXT, SECRETARIAT AND UK AGREED THAT THIS RECOMMENDATION SHOULD BE INCLUDED WITH MEDIUM-TERM PROPOSALS. UK OBSERVED THAT BENEFICIAL FALL-OUT OF NEW INDUSTRIAL STRATEGY INCLUDED BETTER UNDERSTANDING ON PART OF LABOR OF FACT THAT PROFITS MEANT JOBS.

16. MONETARY POLICY: UK ACCEPTED SECRETARIAT JUDGEMENT THAT MONETARY POLICY HAD CONTRIBUTED TO PRESSURE ON EXCHANGE RATE IN 1976 (POINT ALSO MADE BY U.S.), BUT FELT THAT THIS DID NOT RESULT, AS SECRETARIAT HAD INDICATED, FROM INCONSISTENCY BETWEEN AUTHORITIES' DESIRE TO KEEP INTEREST RATES LOW WHILE HOLDING DOWN GROWTH OF MONETARY AGGREGATES. UK INSISTED THAT TO EXTENT THAT THEY HAD

PURSUED INTEREST RATE TARGET LAST YEAR, THIS OBJECTIVE WAS SUBSERVIENT TO THAT OF HOLDING GROWTH OF AGGREGATES ON COURSE. SIMILARLY, UK ASSERTED THAT SECRETARIAT HAD ERRED IN INTERPRETING FALL IN INTEREST RATES IN EARLY 1977 AS RELAXATION OF MONETARY POLICY AND NOTED THAT M3 HAD ACTUALLY FALLEN IN JANUARY OF THIS YEAR (AS WELL AS IN DECEMBER, 1976). AFTER CONSIDERABLE DEBATE ON THESE ISSUES, EDRC AGREED THAT UK'S MISTAKE HAD BEEN TO INTRODUCE THE CONCEPT OF TARGETING MONETARY AGGREGATES, WITHOUT INSURING THAT THE TARGETS THUS ESTABLISHED COULD BE MAINTAINED AND WITHOUT GIVING MARKET PARTICIPANTS FULL APPRECIATION OF LIKELIHOOD OF SIGNIFICANT SHORT-TERM FLUCTUATIONS AROUND TARGETED TREND. RESULT OF POOR PUBLIC LIMITED OFFICIAL USE

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RELATIONS JOB WAS FREQUENT INCIDENCE OF DESTABILIZING EXPECTATIONS AND PRESSURE ON STERLING.

17. UK HELPED RESOLVE SECRETARIAT'S DIFFICULTIES IN ASSESSING DEGREE OF RESTRICTIVENESS IMPLIED BY LIMITING GROWTH OF DOMESTIC CREDIT EXPANSION (DCE) TO 9 BILLION POUNDS IN YEAR ENDING IN APRIL, 1977. GIVEN LIKELY DEVELOPMENTS IN BALANCE OF PAYMENTS AND IN PSBR, UK SAID THAT TARGET FOR DCE WOULD TRANSLATE INTO M3 GROWTH OF 13 PERCENT; I.E., LESS THAN THAT OF NOMINAL GDP AND THUS RESTRICTIVE. THEY ADDED THAT 7.7 BILLION POUND DCE TARGET FOR YEAR ENDING APRIL, 1978 WOULD BE REVIEWED IN LIGHT OF EVOLUTION OF PSBR AND BALANCE OF PAYMENTS, BUT INDICATED THAT PRESENT INDICATIONS WERE THAT THIS TARGET WAS SOMEWHAT HIGH IN TERMS OF THE IMPLIED GROWTH OF M3.

18. UK NOTED THAT ALTHOUGH MONETARY SECTOR HAD NOT YET BEEN FULLY INTEGRATED INTO MODEL OF UK ECONOMY, INVERSE RELATIONSHIP BETWEEN LEVEL OF INTEREST RATES AND INVESTMENT WAS CLEAR. THUS IMPORTANT HMG GOAL CURRENTLY IS TO ALLOW FALL IN INTEREST RATES, BUT TO PREVENT RATES FROM FALLING SO LOW AS TO CREATE EXPECTATION OF SHARP RISE NEXT SUMMER WHICH, AS EXPERIENCE OF 1976 HAD SHOWN, COULD BECOME SELF-FULFILLING PROPHECY AND WOULD HAVE DELETERIOUS EFFECT ON INVESTMENT.

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19. SECRETARIAT (IN ANNEX I TO REFD0C) PRESENTED THUMB-
NAIL INSTITUTIONAL ANALYSIS OF UK MONETARY POLICY AND
CONCLUDED THAT ONE WAY TO INCREASE FLEXIBILITY OF MONE-
TARY POLICY AND OF DEBT MANAGEMENT WOULD BE TO ISSUE
INDEXED BONDS. U.S. ENUMERATED (WITH UK SUPPORT) THE
MANY DISTORTIONS THAT INDEXATION WOULD GENERATE IN DOMES-
TIC AND INTERNATIONAL CAPITAL MARKETS. SECRETARIAT AGREE
TO REDRAFT ANNEX TO SHOW INDEXATION ALTERNATIVE AS ONE
POSSIBLE INSTITUTIONAL INNOVATION RATHER THAN AS A RECOM-
MENDATION.

20. MEDIUM-TERM POLICY: UK SUPPORTED CONCLUSION OF
SECRETARIAT ANALYSIS (SEE REF D, PARA 13) THAT POLICIES
DESIGNED TO OPTIMIZE USE OF OIL REVENUES IN MEDIUM TERM
SHOULD AIM AT MIDDLE GROUND BETWEEN OPTIONS OF (A) MAXI-
MIZING CURRENT ACCOUNT SURPLUS AND (B) STRIVING FOR FULL
EMPLOYMENT. THEY FELT, HOWEVER, THAT SECRETARIAT PRE-
SENTED OVERLY-SANGUINE VIEW OF AVERAGE ANNUAL CURRENT
ACCOUNT DEFICIT (\$2.25 BILLION) OVER RELEVANT PERIOD
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(1977-82) WHICH WOULD CONSTITUTE PRUDENT MIDDLE GROUND.
UK STRESSED THAT OIL REVENUES WOULD EASE, BUT NOT ELIMI-
NATE (AS SECRETARIAT IMPLIED) THE CURRENT ACCOUNT CON-
STRAINT OVER MEDIUM TERM AND DROVE POINT HOME BY LISTING
VARIOUS PRIOR CLAIMS ON EXPECTED CURRENT ACCOUNT SURPLUS.
THESE CLAIMS INCLUDE: (A) EXPORT CREDITS GENERALLY HAVE
EXCEEDED IMPORT CREDITS AND NET CREDITS CAN BE EXPECTED

TO EXPAND PARI PASSU WITH GROWTH OF EXPORT VALUE; (B) CALCULATIONS OF CURRENT ACCOUNT SURPLUS INCLUDE PROFITS FROM OVERSEAS COMPANIES, LARGE PORTION OF WHICH IS REINVESTED OR RETAINED AND IS THUS NOT REPATRIATED; (C) OUTFLOWS OF INTEREST, PROFITS AND DIVIDENDS ARISING FROM INVESTMENT IN NORTH SEA OIL WILL BE ADDITIONAL DRAIN. (UK ESTIMATES THAT REPAYMENTS ON PUBLIC SECTOR DEBT WILL TOTAL \$20 BILLION BETWEEN 1977 AND 1985.) OBVIOUS UK MOTIVATION IN URGING THAT PUBLISHED SURVEY RENDER CAUTIOUS ASSESSMENT LATITUDE FOR EXPANSION OF CONSUMPTION AFFORDED BY NORTH SEA OIL WAS TO HELP TEMPER PUBLIC EXPECTATIONS IN THIS RESPECT. U.S. PRAISED UK'S PRUDENCE IN THEIR ASSESSMENT. ON OTHER HAND, UK SUGGESTED THAT LARGER CURRENT ACCOUNT SURPLUS THAN FORESEEN IN SECRETARIAT'S SCENARIO COULD BE GENERATED BY INCREASING EXPORTS. EDCR CHAIRMAN NOTED THAT "OPTIMAL" PATH OUTLINED BY SECRETARIAT ALREADY POSTULATED AVERAGE ANNUAL GROWTH RATE OF MANUFACTURING (5 PERCENT) AND OF INVESTMENT (9 PERCENT) THAT WERE FAR IN EXCESS OF PAST TRENDS. UK RESPONDED THAT AIM OF PRESENT POLICIES WAS TO BREAK WITH PAST TRENDS. WHILE EDCR ACCEPTED THIS POINT, IT IS CLEAR THAT ACHIEVEMENT OF LARGER CURRENT ACCOUNT SURPLUS BETWEEN 1977 AND 1982 WILL HAVE TO BE AT THE EXPENSE OF PUBLIC OR PRIVATE CONSUMPTION. LET US HOPE THAT UK CHOOSES TO COMPRESS PUBLIC CONSUMPTION.

21. POINTS RAISED REF B, PARAS 2-9 COVERED PARAS 10, 16, 6-9, 5 AND 15.
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Current Classification: UNCLASSIFIED
Concepts: ECONOMIC DEVELOPMENT, COMMITTEE MEETINGS, ECONOMIC REPORTS
Control Number: n/a
Copy: SINGLE
Sent Date: 03-Mar-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977OECDP06291
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D770073-0855
Format: TEL
From: OECD PARIS
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770397/aaaadhni.tel
Line Count: 575
Litigation Code IDs:
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Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 6f0d38be-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 11
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 77 LONDON 2885, 77 LONDON 20292, 77 OECD PARIS 4809
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 03-Feb-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3219756
Secure: OPEN
Status: NATIVE
Subject: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC) REVIEW OF UK ON FEBRUARY 24.
TAGS: ECON, OECD
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/6f0d38be-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009